Guerdon Associates
Executive Pay & Board Governance
a GECN GROUP company

PRIVATE AND CONFIDENTIAL

1 June 2021

Market Conduct Division
The Treasury
Langton Crescent
Parkes ACT 2600

By email: MCDproxyadvice@treasury.gov.au

Dear Manager,

Greater Transparency of Proxy Advice
Submission on the Consultation Paper

Guerdon Associates appreciates the opportunity to provide its submission on the *"Greater Transparency of Proxy Advice"* Consultation Paper dated April 2021(the paper).

This submission describes our firm, responds to each of the options and questions in the Treasury paper, and identifies other aspects of relevance to proxy adviser regulation.

About Guerdon Associates

Guerdon Associates is an independent[1] executive and board remuneration and governance consulting firm. Our clients include a significant proportion of companies in the ASX 300, large private companies and pre-IPO companies. Offices are located in Melbourne and Sydney, with affiliate offices in London, Paris, Zurich, Kiev, New York, Los Angeles, Johannesburg, and Singapore. The firm has worked with the boards of many of Australia's ASX-listed companies across all GICS sectors, as well as regularly liaising with superannuation funds, asset managers and institutional investors.

The firm's submissions were among the most cited in the Productivity Commission's review of executive remuneration and, over the years, it has contributed to Treasury, Australian Taxation Office, and CAMAC on numerous Corporations Act and taxation legislation changes, as well as regularly engaging with ASIC and APRA on remuneration and governance matters.

As a provider of remuneration and governance advisory services and an expert observer of the impact of proxy advice on institutional investor voting issuers' interactions with proxy advisers and response to their advice, the firm can provide useful insight into:

- the effects of proxy advice on institutional investor voting; and

[1] Independence is defined as a specialist provider of consulting services to company boards only, and not management, to minimise conflicts of interest that may otherwise result from being a supplier of multiple services to both management and boards.

- the potential costs and benefits for capital markets participants of the proposals outlined in the paper.

Independence between superannuation funds and proxy advice

Treasury has requested stakeholder views on the following options aimed at improving independence of proxy advisers for the purposes of ensuring superannuation funds are held to the highest standards of governance and transparency.

Treasury proposed Option 1: Improved disclosure of trustee voting. *Under this option, superannuation funds would be required to disclose more detailed information in relation to their voting policies and actions for each financial year. The details to be disclosed could include how votes were exercised, whether any advice was received from a proxy adviser and who provided the advice.*

If proxy advice is received, disclosure could include whether the voting actions taken were consistent with the proxy advice.

As Guerdon Associates understands the proposal, superannuation funds will be required to disclose that, if proxy advice was received, who provided the advice, in addition to the existing requirement for superannuation funds to **disclose** how the fund has exercised its voting rights in relation to shares in listed companies[2].

More disclosure and transparency should provide regulators, superannuation fund members and others with information to assess the extent to which superannuation funds have not abrogated their responsibility by simply adopting the voting recommendation of the proxy adviser, and that they have independence of mind to act in members' interests. In this regard, the proposal falls short of improving superannuation governance. It does not require disclosure of the proxy advice, i.e. whether for, against or abstain from a resolution vote. This can then be compared to disclosure of how the fund voted. Voting in lockstep with a proxy adviser's advice infers little independence of mind.

Additionally, there is no requirement for a statement from the fund of reasons it did not support a company-initiated and recommended resolution. This not only assists an assessment of independence, it also permits members and other stakeholders to judge the soundness of decision making.

Lastly, asset managers are AFSL licensees that may provide the superannuation fund with proxy advice, and may lodge votes in accord with beneficial owner contractual provisions, and may receive proxy adviser recommendations. Several large foreign-owned asset managers vote in lockstep with a proxy adviser. Given this and the Treasury's aim of increased transparency, the same disclosure provisions should apply to asset managers.

The disclosure of trustee voting and the rationale for that vote is a sound principle for the improvement of transparency for member interests. If such a proposal was

[2] section 2.38(2) of the Superannuation Industry (Supervision) Regulations 1994 (SIS Regulations) at http://classic.austlii.edu.au/au/legis/cth/consol_reg/sir1994582/s2.38.html

to be implemented then it should apply equally to all asset owners, superannuation funds and entities that hold interests on behalf of others and vote on issuer resolutions. There is no logical reason to carve out only a small component of the capital markets for this disclosure.

Guerdon Associates' recommendation on Option 1

Large superannuation fund disclosure would include:

- the policies of the trustee in respect of voting on company resolutions
- the fund's equity holdings in each company
- the way in which the fund voted in respect of each meeting resolution
- the reason why the fund voted against a resolution put forward by the company
- where voting has been delegated to an external asset manager, the way in which the asset manager voted in respect of each meeting resolution
- the reason why the asset manager voted against a resolution put forward by the company
- the proxy adviser name and proxy advice received for each resolution and whether the votes were consistent with this advice.

Alternatively, instead of disclosing votes delegated to external asset managers, disclosures could indicate the extent of votes delegated, and similar reporting requirements be applicable to external asset managers.

Treasury proposed Option 2: Demonstrating independence and appropriate governance. *Under this option, proxy advisers would be required to be meaningfully independent from a superannuation fund they are advising to ensure that proxy advice is provided to and used by superannuation funds on an 'arm's length' basis.*

Trustees could also be required to outline publicly how they implement their existing trustee obligations and duties around independent judgement in the determination of voting positions.

The fiduciary obligations of superannuation fund trustees and managers will include reducing administrative costs of members as well as minimising member risk by improving investment governance. Utilising proxy advisers does both.

Further, large insitutional investors, such as industry superannuation funds, invest in most ASX-listed companies. It is in their members' interests to improve governance of all ASX-listed entities, particuarly over the longer term, which is arguably enabled via an investment in a proxy adviser.

Investing in, and owning, a proxy adviser as it competes for members does not present a conflict of interest, given that industry superannuation funds are not the entire market.

In addition, the larger of the industry funds receive proxy advice from more than one proxy adviser to ensure they have a balanced perspective. This is not to say that industry funds do not have an undue influence on the proxy adviser they own. On some issues it is believed that they have. This conflict often arises as industry funds weigh the need to satisfy uninformed members' views on, say, executive pay, with the need to ensure high and consistent standards of governance in the companies in which they invest. On some occasions, the 'court of public opinion" and social media may have interefered in the formulation of sound and consistent proxy advice. But these instances have been rare, and we believe are offset by the advantages of lower costs and a greater diversity of proxy advisers than would otherwise be the case.

The full implications and consequences of what is being put forward also need to consider future ownership changes.

It was not so long ago that CGI Glass Lewis was owned by a single Canadian pension fund. It does not take much imagination to see that a single pension fund owner has a greater conflict of interest than a group of competing superannuation funds owning a similar business. What if this were to happen again? Would one of the foreign-owned proxy adviser funds taken over by foreign pension funds be banned from offering services in Australia?

ISS is owned by private equity. A private equity owner with multiple interests and investment strategies, but a shorter-term investment horizon, may have as much of a conflict of interest, if not more, than a group of superannuation funds.

Jointly owning a proxy adviser does not free a superannuation fund of its fiduciary duties to members.

Guerdon Associates' recommendation on Option 2

- Superannuation funds should not be prevented from investing in, or owning, a proxy adviser.
- Proxy adviser disclosure of conflicts of interest, as required under their AFSL license, be rigorously enforced.

Consultation questions

1. How would the proposed options affect superannuation fund members?

Option 1 would assist members to understand the way in which the fund is exercising its stewardship over the investments on their behalf if the disclosure requirements are carefully captured.

It does not appear that the disclosure requirements are sufficient. In addition to disclosing how a fund voted on each resolution, it should also state the voting delegated to external asset managers, the reason for not supporting

a company-initiated resolution, the proxy advisers providing advice and the proxy recommendation made.

Asset managers that have delegated authority to vote on an owners' behalf should be required to disclose on a similar basis.

Option 2 will not benefit members and is more than likely to result in poorer returns for members as the industry fund incurs higher costs on sourcing its proxy advice. It may have the unintended consequence of further concentrating the proxy advice market, offering less choice, less diversity, less innovation, higher prices, and poorer outcomes.

2. What impact would the proposed options have on superannuation funds in complying with these regulatory requirements?

Option 1 will increase the administrative costs for superannuation funds but the overall benefits for members and issuers would outweigh the marginal cost increase. Costs will be proportionately higher for those with fewer internal governance resources.

Option 2 will significantly increase costs for the superannuation funds and result in lower returns for members. There are no perceived benefits for Option 2.

3. What should be the regularity and timing of reporting? For example, should trustees be required to provide their proxy voting policy to members ahead of an AMM?

Disclosure of the voting policies can be provided on funds' websites under the corporate governance label and updated as required.

Disclosure of voting actions and the reasons for the vote should be published on websites each quarter in respect of voting actions in that quarter.

The disclosure of voting policies and voting actions by asset managers should be on the same basis as superannuation funds to be consistently transparent.

4. What other information on how voting is informed by proxy advice should be disclosed by superannuation funds and why?

The proxy adviser, and proxy advice for each resolution voted on.

The reason for voting against a company-initiated resolution.

5. What level of independence between a superannuation fund and a proxy adviser should be required?

This should not be specified. A proxy adviser is required to disclose conflicts of interest. Buyers of services can assess the extent to which the proxy advice meets their needs.

6. **Which entity should the independence requirement apply to (superannuation fund or proxy adviser)?**

See above.

Engagement between companies and proxy advisers

The Treasury paper provides the following introductory comments in relation to the options for engagement:

"Currently, proxy advisers are not required to engage with companies on their research, report and recommendations, either before or after providing their reports to investors.

Business representative groups have raised the importance of companies being able to engage with proxy advisers and being able to present their views to the investors who receive the reports, including in situations where a company may disagree with some of the research or recommendations in the reports. The opportunity to engage allows companies to point out any factual inaccuracies and convey additional context or information to the proxy adviser that may impact the final voting recommendation. This is important given that there are only a few proxy advisers that are providing advice to what is a large proportion of the shareholder base for some companies.

Given that AGMs are not distributed evenly throughout the year, with a high proportion of Australia's AGMs happening in the last quarter of the year, large institutional investors may have limited capacity to engage with multiple sources of information in relation to each AGM. Having proxy advice accompanied by the company's response to that advice, or a simple direction on how to find it, would simplify accessing and contrasting information and perspectives.

Stakeholder views are sought on options that are aimed to facilitate engagement and transparency."

Treasury proposed Option 3: Facilitate engagement and ensure transparency. *Under this option, proxy advisers would be required to provide their report containing the research and voting recommendations for resolutions at a company's meeting, to the relevant company before distributing the final report to subscribing investors. For example, a period of five days prior to the recommendation being made publicly available would give enough time for both the company and proxy adviser to comment and for the proxy adviser to amend the report in response if warranted.*

Companies are required to conduct an AGM within 5 months of the financial year end. Listed companies are required to give 28 days' notice of the AGM. Currently, proxy advisers provide advice 14 to 21 days prior to an AGM. This is about 16 days prior to voting cut-off via custodians. The typical large superannuation fund receives its notice via a voting platform and is working to a deadline to lodge votes with a custodian. The date of lodgement with the custodian is typically 5 days before the meeting – i.e., a total of 23 days to lodge votes if votes were to be lodged at the last minute. So, the large industry superannuation fund works to the following timetable:

- Notice of Meeting received via a voting platform: day 1, 22 days to go

- Proxy adviser recommendations: at best, day 14, 8 days to go
- Superannuation fund seeks asset manager input for proxy adviser against recommendations: day 15, 7 days to go
- Superannuation fund escalates decisions due to asset manager disagreement: day 20, 3 days to go.
- Day 23, Vote lodgement advice with custodian

Clearly, there is no room for the proxy adviser to deliver a report later to their client.

The Treasury paper proposal requires the proxy adviser to collate data, consider the resolutions, decide on the resolutions, and prepare advice in 2 days to deliver to issuer 5 days before delivering its final report to clients for their voting consideration.

During peak proxy season there may be 40 AGMs in a day, with 4 to 5 resolutions each.

Logistically this is not possible given current proxy adviser resources unless quality standards are set lower, or resourcing and pricing to be met by superannuation funds is to be set higher.

Companies will find errors, and do the work of proxy advisers correcting these.

There is also no consideration for proxy advisers changing their position between sharing a report with issuers and delivering the final version to clients. Clearly, they should not be beholden to issuers for changing their position, especially if new facts become apparent from engagement.

There is also the question of market efficiency and effectiveness. Company disclosures should be sufficient so that an investor can make a fully informed decision independent of additional information in a proxy adviser report gleaned from engagement communication post release of the report. If the latter occurs, disclosures are lacking. If an issuer has a fall-back position on which they can disclose more context in engagement meetings, then this would be unfair to those that do not receive proxy advice reports. In other words, it would seem that company disclosures would be inconsistent, and the market not fully informed at the same time.

Option 4: Make materials accessible. *Under this option, proxy advisers would be required to notify their clients on how to access the company's response to the report. This could be through providing a website link or instructions on how to access the response elsewhere.*

This is a requirement under US regulations. It is a useful, cost effective method for issuers to directly address proxy adviser errors and differences in opinion with those that receive the specific proxy advice. This can be delivered and considered in the window when superannuation funds are also considering input from asset managers.

Consultation questions

1. **How would the proposed options affect the level of engagement by proxy advisers with companies?**

   There will be a higher level of proxy adviser engagement with issuers. However, this would mainly be focussed on correcting errors that may not have otherwise occurred given time constraints. It would be preferred that higher quality engagement be undertaken when advice is being formulated about material matters, and not engagement based on correcting data errors.

2. **Would the proposed options mean that investors are more likely to be aware of a company's position on the proxy advice they are receiving?**

   Option 4 will achieve this.

   At present, at least one proxy adviser will not include any information from engagement meetings that are not publicly disclosed.

   However, investors who do not receive the proxy advice will not be aware of the company's position. This means a less efficient market. It is better to encourage better standards of disclosure and make the company's response publicly available, even if the proxy advice is not.

3. **What is the most appropriate method for proxy advisers to notify their clients as to where the company's response to its report is?**

   There are multiple methods. CGI Glass Lewis sends an amended report with a link to the company's response. This is as good as any.

   Alternatively, proxy advisers can provide access through their site portal.

4. **If proxy advisers were required to provide their reports to companies in advance of their clients, what would an appropriate length of time be that allows companies to respond to the report and for the report to be amended if there are any errors?**

   There is little time to do this, as illustrated in our commentary on Option 3. Errors can be pointed out in the company's response sent to proxy advisers' clients as per Option 4. This may best illustrate to the clients the quality of their proxy adviser's advice, and serve to increase competition via report quality.

5. **Are there any requirements that should be placed on companies during this period, such as confidentiality?**

   This proposal potentially means the company may be in possession of price sensitive information that may or may not change and can lead to inconsistent and potentially misleading disclosures.

   Are there any requirements that should be placed on proxy advisers during this period, such as not making their recommendation otherwise publicly

known?

It is currently not usual for the proxy adviser to engage with clients as they formulate their advice. This requirement would preclude this practice, potentially reducing the independence of advice.

Concluding remarks

Guerdon Associates trusts that our observations and suggestions are of value. We would be pleased to respond to any queries you may have in relation to this submission.

Yours faithfully

Guerdon Associates